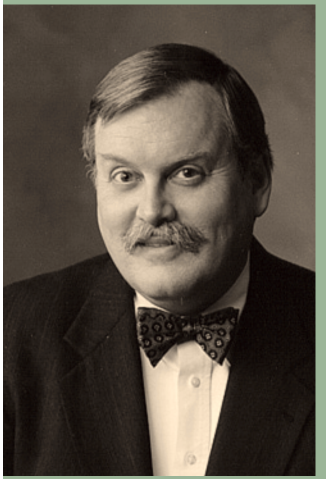
Predicting the future—a chancy endeavor—especially today



"... if pressed to gaze into my crystal ball, I'd say there are four key issues we will face this year..."

See next page

Last November, I predicted the presidential election controversy would be resolved by Thanksgiving. Obviously, I was wrong.

Predicting what will happen in the power industry is equally risky. But if pressed to gaze into my crystal ball, I'd say there are four key issues we will face this year—reliability, regional transmission organizations, California's power market and purchased power funding.

Reliability

Last year, especially during the summer and fall in California, reliability surfaced as a critical issue. Driven largely by uncertainty in the power industry and deregulation, portions of the country faced a real dilemma—not enough power or no way to get it where it's needed.

Making things worse is how utilities deal with one another. The days of "a gentleman's agreement" to help one another keep the lights on are gone. Today, we are increasingly competitors. There no longer is a culture of mutual support. This threatens reliability.

The 106th Congress failed to pass legislation that would mandate reliability standards. In the absence of this legislation, the Western Systems Coordinating Council launched its Reliability Management System. Under this system, utilities (including Western) signed contracts to adhere to specific reliability standards—or face sanctions, including fines.

In the next Congress, the North American Electric Reliability Council will again urge reliability legislation, based largely on the WSCC model. The "tea leaves" predict it may pass. With the recent history of energy alerts, rolling blackouts and market uncertainty, the time is right. Our industry is demanding it.

RTO formation

Currently, Western is involved with five prospective RTOs: RTO West, Desert STAR, Crescent Moon, the California Independent System Operator and Midwest ISO. We have been active participants in the formation processes of most of these. In the case of RTO West, we've been vigilantly monitoring its formation status.

We will continue to participate and monitor these RTOs as they evolve, or fail. Given our 17,000 miles of transmission lines extending through 15 western states, Western will be a player in any RTO. We need to ensure that any RTO we join will allow us to carry out our mission of serving preference customers with cost-based power. Equally important, we must ensure that any costs linked with creating and operating an RTO are justified by the benefits Western, and our customers, receive. Joining an RTO must make good business sense.

California energy crisis

The problems encountered in California and elsewhere this year are not likely to go away. In fact, they may worsen next year. Many in California view the Federal hydro system as a silver bullet that will cure all energy ills. For example, some propose expanding or eliminating the concept of preference so that investor-owned utilities like San Diego Gas and Electric Company could acquire our cost-based power. Still others suggest the entire state's power infrastructure should be operated by a public state utility, including Federal assets. Both are unlikely to come about. However, these views highlight our need to better educate people on our role and mission.

Purchased power

In this year's budget, we received the authority to spend up to $65 million from our revenues for purchased power. At the time, we thought this would be enough to fund our purchased power requirements. Little did we anticipate that wholesale prices would explode from $20 per megawatthour to $1,200 per MWh, and more. So far this year, Loveland Area Projects spent more than twice as much for less energy than they did for the whole of 2000.

For the Central Valley Project, purchased power costs have skyrocketed to the point Sierra Nevada Region is proposing to raise its rates 22 percent. Similarly, the Colorado River Storage Project Management Center is proposing a rate formula for Salt Lake City Area/Integrated Projects that can add 11 mills to the current 17-mill rate.

Why have purchase power prices become so dear? The chaotic California market has significantly fueled the unprecedented rise in wholesale prices. Natural gas prices have contributed to the problem. Over the past year, gas prices have increased nearly threefold—something we've probably all noticed in our utility bills.

Other factors add to the problem. Glen Canyon Powerplant's capacity is 1,300 MW. But, as a result of an Environmental Impact Statement and U.S. Fish and Wildlife Service biological opinion, flows have been cut to protect the downstream environment. This has reduced generation to 900 MW. To make matters worse, dry conditions triggered a "low-flow" study this summer prescribed by the EIS and biological opinion. This study further limited output to 340 MW.

Sierra Nevada faces similar flow restrictions on the Trinity River, as does the Upper Great Plains Region on the Missouri. The draining of Horsetooth Reservoir in the Rocky Mountain Region to repair sinkholes and the dam will restrict power production for the next three to four years. To replace the power foregone for these reasons, our purchased power costs will likely remain high, especially if we have another dry year.

Solutions

There are no quick and easy fixes for these challenges. But here's what we are doing to address them. In addition to the proposals for the CVP rate increase and SLCA/IP rate adder, we're working with our customers to develop advance-funding arrangements to help cover purchased power costs. And we expect to request that Congress increase our purchased power appropriations.

Many people across Western have been working hard and long hours to find solutions to increasing costs in a constantly changing, volatile industry. We will remain committed to providing reliable, cost-based energy to our customers.